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SUBJECT: NICARAGUA: INVESTMENT CLIMATE STATEMENT 2008

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OPENNESS TO FOREIGN INVESTMENT

Legal Framework

¶1. The Free Trade agreement between the United States, Central America, and the Dominican Republic (CAFTA-DR) entered into force on April 1, 2006, for the United States and Nicaragua. The CAFTA-DR Investment Chapter establishes a secure, predictable legal framework for U.S. investors in Central America and the Dominican Republic. The agreement provides six basic protections: (1) nondiscriminatory treatment relative to domestic investors and investors from third countries; (2) limits on performance requirements; (3) the free transfer of funds related to an investment; (4) protection from expropriation other than in conformity with customary international law; (5) a minimum standard of treatment in conformity with customary international law; and (6) the ability to hire key managerial personnel without regard to nationality. For additional information about CAFTA-DR and USAID support for the implementation of CAFTA-DR, see www.ustr.gov/TradeAgreements/Bilateral/CAFTA/SectionIndex.html and www.procafta.net.

¶2. In addition to CAFTA-DR, Nicaragua's Foreign Investment Law defines the legal framework for foreign investment. The law allows for 100% foreign ownership in most sectors (see Right to Private Ownership and Establishment for exceptions). It also establishes the principle of national treatment for investors, guarantees foreign exchange conversion and profit repatriation, clarifies foreigners' access to local financing, and reaffirms respect for private property.

¶3. Other major laws governing foreign investment include the Temporary Entry Law, which allows for the duty free import of machinery, equipment, raw materials, and supplies for companies exporting the majority of their production (see Performance Requirements and Incentives); the Export Processing Zone Law (see Foreign-Trade Zones/Free Ports); the Tax Equity Law (see Performance Requirements and Incentives); the Banking Law (see Conversion and Transfer Policies and Performance Requirements and Incentives); and a series of intellectual property laws (see Protection of Property Rights). In 2006, the Nicaraguan National Assembly approved a Competition Law, but the law has not yet been implemented (see Transparency of the Regulatory System). In 2005, the government amended the Tourism Incentive Law to strengthen incentives for investment in that sector (see Performance Requirements and Incentives). See www.asamblea.gob.ni/ for the Spanish-language text of Nicaraguan law.

Policy Environment

¶4. Since taking office again in January 2007, President Ortega has maintained the legal and regulatory underpinnings of the market-based economic model of his predecessors. Nicaragua has stayed current with its CAFTA-DR obligations. Under an IMF program signed in October 2007, the Government of Nicaragua agreed to implement free market policies linked to targets on fiscal discipline, spending on poverty, and energy regulation.

¶5. In practice, however, a number of factors contribute to an increasingly uncertain policy environment for foreign investors. Government often announces economic policies, programs, or decrees without formal consultation with the private sector. On more than a dozen occasions, the government has used its tax, customs, and property administrations to pressure individuals and companies into accepting noncommercial terms in concessions or contracts (see Dispute Settlement, Transparency of the Regulatory System, and Expropriation and Compensation for examples). High profile rulings by the courts and oversight agencies are unpredictable and widely believed to be politicized. President Ortega has repeatedly suggested that it was a mistake to privatize the telecommunications and energy industries, where a number of foreign firms have invested; he has not ruled out re-nationalization, although no formal plans exist. Local business associations have complained that President Ortega's harsh rhetoric against the United States, capitalism, and free trade has had a negative effect on foreign investor attitudes and perceptions of risk when they think of Nicaragua (for official copies of speeches in Spanish see www.presidencia.gob.ni).

¶6. After successive years of improvement, Nicaragua fell in the World Economic Forum's Competitive Index Rankings from 95th place in 2006 to 111th in 2007. Significant slippage occurred in the quality of Nicaraguan institutions and market efficiency components of the index. In 2008, the Heritage Foundation Index of Economic Freedom ranks Nicaragua 81st (at the 60.1 percentile) worldwide for economic freedom, down from 65th (at the 61.9 percentile) in 2007. However, the Heritage Foundation has maintained Nicaragua's placement at the 70th percentile on investment freedom, one of ten components comprising its Index of Economic Freedom (see www.heritage.org/research/features/index/).

CONVERSION AND TRANSFER POLICIES

¶7. The Foreign Investment Law (2000/344) and the Banking, Nonbank Intermediary, and Financial Conglomerate Law (2005/561) allow investors to freely convert and transfer funds associated with an investment. Article 10.8 of CAFTA-DR ensures the free transfer of funds related to a covered investment. Local financial institutions freely exchange U.S. dollars and other foreign currencies. Foreigners may open bank accounts, but the process is cumbersome and time consuming. The Superintendent of Banks and other Financial Institutions monitors financial transactions for illicit activity.

¶8. On several occasions, most recently in October 2007, President Ortega has suggested that foreign investors should reinvest their profits locally rather than repatriate them. To date, the government has prepared no formal policy proposals on this topic.

¶9. The official exchange rate is adjusted daily according to a crawling peg that devaluates the cordoba against the U.S. dollar at an annual rate of 5%. The official exchange rate as of February 15, 2007, was 19.02 cordobas to one U.S. dollar. As a result of local food and international energy prices, inflation rose to 16.2% in 2007 (from 10.2% in 2006), placing stress on Nicaragua's crawling peg regime.

EXPROPRIATION AND COMPENSATION

¶10. During the 1980s, the Sandinista government confiscated 28,000 real properties. Since 1990, thousands of individuals have filed claims against the government to have their property returned or

receive compensation. Compensation is most often in the form of low-interest bonds issued by the government. As of December 2007, the Nicaraguan Government had settled more than 4,500 U.S. citizen claims. A total of 677 Embassy-registered U.S. claims remain. In December 2007, the Ortega administration established unrealistic standards of proof to demonstrate ownership and expropriation, and announced plans to dismiss claims accepted by previous administrations. The Ortega administration also sought to retroactively review already settled claims. The U.S. Embassy in Nicaragua is contacting claimants and working to ensure that the property rights of U.S. citizens are respected. A U.S. citizen with such a claim may contact managuaproffice@state.gov.

¶11. CAFTA-DR prohibits expropriation unless for a public purpose. The government must pay prompt, adequate, and effective compensation. See [www.ustr.gov/Trade Agreements/Bilateral/CAFTA/Section Index.htm](http://www.ustr.gov/TradeAgreements/Bilateral/CAFTA/Section%20Index.htm) for additional information.

¶12. In August 2007, the Nicaraguan Government seized, via judicial order, several petroleum storage tanks owned by a U.S. company on the pretext that the company had not paid value-added taxes associated with the import of crude oil, despite the fact that petroleum and petroleum products are not subject to this tax and no mechanism exists to collect it. The government then used the tanks to store petroleum products imported from Venezuela under the terms of a government-to-government financing agreement. In January 2008, the U.S. company sold the tanks in question to state-owned company Petronic and negotiated a purchase agreement with Petronic for crude oil imported from Venezuela.

¶13. See Protection of Property Rights for a description of other forms of land security problems affecting investors.

DISPUTE SETTLEMENT

¶14. Difficulty in resolving commercial disputes, particularly the enforcement of contracts, remains one of the most serious drawbacks to investment in Nicaragua. The legal system is weak, cumbersome, and members of the judiciary, including those at senior levels, are widely believed to be corrupt or subject to political pressure. A commercial code and bankruptcy law exist, but both are outdated.

¶15. Enforcement of court orders is frequently subject to nonjudicial considerations. Courts routinely grant injunctions ("amparos") to protect citizen rights by enjoining official investigatory and enforcement actions indefinitely. Foreign investors are not specifically targeted, but they are often at a disadvantage in disputes against nationals with political or personal connections. Misuse of the criminal justice system sometimes results in individuals being charged with crimes arising out of civil disputes, often to pressure the accused into accepting a civil settlement. The World Bank estimates that on average local courts issue a preliminary ruling on contract disputes in 540 days. Monetary judgments normally are rendered in Nicaraguan currency, but may be denominated in U.S. dollars.

¶16. Dispute resolution is even more difficult in the Northern and Southern Atlantic Autonomous Regions (RAAN and RAAS, respectively), where most of the country's fishery, timber, and mineral resources are located. These large regions, which share a Caribbean history and culture, comprise more than one-third of Nicaragua's land mass. The division of authority between the central government and regional authorities is complex and flexible. Local officials may act without effective central government oversight.

¶17. The Mediation and Arbitration Law (2005/540) establishes the legal framework for alternative dispute resolution. Nicaragua is a signatory of the New York Convention and the Inter-American Convention on International Commercial Arbitration. Arbitration clauses should be included in business contracts if one has doubts about the Nicaraguan judicial system. In January 2008, the Nicaraguan Chamber of Commerce and the American Chamber of Commerce of Nicaragua announced plans to merge their mediation and arbitration centers.

¶18. CAFTA-DR establishes an investor-state dispute settlement

mechanism. An investor who believes the government has breached a substantive obligation under CAFTA-DR or that the government has breached an investment agreement may request binding international arbitration. Proceedings under this mechanism are generally open to the public and documents are made publicly available.

¶119. Several U.S. companies and the U.S. Chamber of Commerce in Washington have voiced their concern that Nicaraguan Law 364, enacted in 2000 and implemented in 2001, presumes guilt without due process and retroactively imposes arbitrary liabilities on foreign companies that manufactured or allegedly used or distributed the chemical pesticide DBCP in Nicaragua. DBCP was banned in the United States after the Environmental Protection Agency cancelled its certificate for use (with exceptions) in 1979.

¶120. In January 2007, employees who own 40% of a local pharmaceutical company forcefully took possession of the company's manufacturing facilities as the result of a dispute with management.

Several U.S. citizens own shares in the company. The majority owners of the company have been unsuccessful in their attempts to regain control of the facilities through action in the courts and are participating in negotiations with employees brokered by the Nicaraguan Government.

PERFORMANCE REQUIREMENTS AND INCENTIVES

Performance Requirements

¶121. Nicaragua's labor code states that 75% of employees, not including management posts, must be Nicaraguan. The Law on Promotion of National Artistic Expression and Protection of Nicaraguan Artists (1996/215) requires that foreign production companies contribute 5% of total production costs to a national cultural fund. In addition, the law requires that 10% of the technical, creative, and/or artistic staff be locally hired. Under CAFTA-DR, Nicaragua does not require U.S. film productions to contribute to the cultural fund or hire locally.

Investment Incentives

¶122. The Tax Equity Law (amended 2005/528) allows firms to claim an income tax credit of 1.5% of the FOB value of the exports. The Law of Temporary Admission for Export Promotion (2001/382) allows for businesses to purchase machinery, equipment, raw materials, and supplies duty and VAT free if used in export processing. Businesses must export 25% of their production to take advantage of these tax benefits. See Foreign Trade Zones/Free Ports for a description of incentives for investments in free trade zones.

¶123. The Fishing and Fish Farming Law (2004/489) exempts gasoline used in fishing and fish farming from taxes. Investors in the sector must register with the Directorate General for Natural Resources in the Ministry of Trade, Industry, and Development and with the Nicaraguan Fishing and Aquaculture Institute (INPESCA). Environmental regulations also apply (see Transparency of the Regulatory System).

¶124. The Forestry Conservation and Sustainable Development Law (2003/462) establishes preferential property tax rates and income tax exemptions in addition to duty and tax exemptions for inputs and capital goods used in forestry projects. In September 2007, the Nicaraguan Government implemented a temporary ban on commercial logging and compelled operators to supply all timber felled by Hurricane Felix to the government for reconstruction of the RAAN after the hurricane. Enforcement of this law appears spotty.

¶125. The Hydroelectric Promotion Law (amended 2005/531) and the Law to Promote Renewable Resource Electricity Generation (2005/532) provide incentives to invest in electricity generation, including duty free imports of capital goods and income and property tax exemptions. Regulatory concerns limit investment despite these incentives (see Transparency of the Regulatory System). Private investment in hydroelectric dams is banned from the Asturias, Apanas, and Rio Viejo Rivers and is limited to 30 megawatts on all other rivers.

¶126. The Special Law on Mining Prospecting and Exploitation (2001/387) exempts mining concessionaires from import duties on capital inputs (see Transparency of the Regulatory System for additional information on the mining sector).

¶127. The Tourism Incentive Law (amended 2005/575) includes the following basic incentives for investments of \$30,000 or more outside Managua and \$100,000 or more within Managua: income tax exemption of 80% to 100%; property tax exemption; exoneration from import duties on vehicles; and value added tax exemption on the purchase of equipment and construction materials.

Immigration Issues

¶128. Those wishing to permanently reside in Nicaragua must request a resident visa from the Office of Immigration in Managua. Investors who live in Nicaragua but fail to obtain a residency permit have encountered immigration problems, including deportation. The Nicaraguan private sector has encouraged the government to establish a short-term business visa category to mitigate the problem. Investors should consult with Nicaraguan immigration authorities to ensure that they have an appropriate visa or resident status while engaging in business.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

¶129. In 1992, the Nicaraguan Government began to privatize small state-owned companies that the first Ortega government had nationalized or established in the 1980s. Subsequent privatization programs managed by the World Bank and Inter-American Development Bank sold state-owned telecommunications and electricity generation and distribution companies. Over the past 15 years, Nicaragua has privatized more than 350 state enterprises.

¶130. The government owns and operates the water and sewage company (ENACAL), the port authority (EPN), and the power transmission company (ENTRESA). Private sector investment is not permitted in these sectors. In addition, the government owns operates the country's largest insurance company (INISER), the largest electricity generating company (ENEL), one free trade zone (Parque Industrial Las Mercedes) and a basic food commodity storage and distribution company (ENABAS). The government enjoys exclusive rights to manage public social security pension funds (see Efficient Capital Markets and Portfolio Investment). In 2000, Spanish company Union Fenosa bought both the north and the south electricity distribution companies from ENEL (see Transparency of the Regulatory System). However, operation of the concession has suffered greatly from weak regulatory oversight and the lack of a supportive legal regime.

¶131. The military and its officers' pension fund have investments in many sectors, especially retail. These companies compete on equal terms with privately owned businesses and do not constitute an impediment to foreign investment.

PROTECTION OF PROPERTY RIGHTS

Real Property

¶132. Many foreign investors experience difficulties defending their property rights in Nicaragua. Property registries suffer from years of poor recordkeeping. Establishing a title history is often difficult. The wrongful expropriation of 28,000 properties in the 1980s has greatly complicated the process. Attracted by escalating property values, unscrupulous individuals have engaged in protracted confrontations with U.S. investors to wrest control of tourist properties along the Pacific coast in the Departments of Rivas and Chinandega. Judges and municipal authorities have been known to collude with such individuals, and a cottage industry supplies false titles and other documents to those who scheme to steal land. Property invasions usually go unchallenged by local law enforcement officials and in some cases turn violent. Although the Ortega administration claims to be committed to protecting individual

property rights, the situation substantially worsened during 2007. As of March 1, 2008, the Embassy is working with 294 U.S. citizens to recover 667 properties confiscated by the Ortega administration in the 1980s.

¶33. The Capital Markets Law (2006/587) provides a legal framework for securitization of movable and real property. The banking system is widening its loan programs for property purchases, but there is no secondary market for mortgages. See Efficient Capital Markets and Portfolio Investment for more information on the financial sector.

Intellectual Property

¶34. CAFTA-DR made Nicaraguan standards for the protection and enforcement of IPR consistent with U.S. and emerging international intellectual property standards. To implement the agreement, Nicaragua has strengthened its legal framework to 1) provide state-of-the-art protections for digital products such as software, music, text and videos; 2) afford stronger protection for patents, trademarks, and test data, including an electronic system for the registration and maintenance of trademarks; and 3) deter piracy and counterfeiting. The Nicaraguan Government has not yet implemented an effective system for test data protection and patent linkage for pharmaceutical products, as required by CAFTA-DR.

¶35. The legal regime for protection of intellectual property rights (IPR) in Nicaragua is adequate but to date enforcement of intellectual property law has been limited. Pirated optical media, including music, videos, and software are sold openly, although in relatively small numbers compared to other countries. In 2006, the government successfully prosecuted a case against a vendor selling pirated DVDs, only to have the conviction overturned months later. In July 2007, the Nicaraguan Government again successfully prosecuted a case in a local court against a Nicaraguan citizen selling pirated music CDs. The offender was sentenced to two years in prison-later reduced to parole-and fined 5,000 cordobas (\$267). The Prosecutor General and National Police are currently investigating 28 intellectual property cases. With Department of Justice assistance in November 2007, Nicaraguan law enforcement and judicial officials collaborated to create a Nicaraguan manual for best practices in investigating and prosecuting intellectual property crimes.

¶36. Major IPR laws include:

- Patent, Utility Model, and Industrial Design Law (amended 2007/634)
- Copyright and Related Rights Law (amended 2006/577)
- Satellite Signal Programming Protection Law (amended 2006/578)
- Trademark and Other Distinctive Signs Law (amended 2006/580)
- Plant Variety Protection Law (1999/318)

¶37. Nicaragua is a signatory to the following international conventions and agreements on intellectual property:

- Mexico Convention on Literary and Artistic Copyrights (1902)
- Buenos Aires Convention on Literary and Artistic Copyrights (1910)
- Inter-American Copyright Convention (1946)
- Universal Copyright Convention (Geneva 1952 and Paris 1971)
- Bern Convention for the Protection of Literary and Artistic Works (1971)
- Geneva Convention for the Protection of Producers of Phonograms (1971)
- Brussels Satellite Convention (1974)
- International Convention for the Protection of New Plant Varieties (1978)
- Agreement on Trade-Related Aspects of Intellectual Property Rights (1994)
- Paris Convention for the Protection of Industrial Property (1996)
- The World Intellectual Property Organization (WIPO) Copyright Treaty and Performances and Phonograms Treaty (2002)

TRANSPARENCY OF THE REGULATORY SYSTEM

¶38. A 2006 World Bank Survey placed Nicaragua in the 32nd percentile (100, best) worldwide for Regulatory Effectiveness (see

<http://info.worldbank.org/governance/>). Investors regularly complain that regulatory authorities are arbitrary, negligent, or slow to apply existing laws, at times in an apparent effort to favor one competitor over another. Lack of a reliable means to quickly resolve disputes with government administrative authorities or business associates has resulted in some disputes becoming intractable (see Dispute Resolution).

¶139. Registering a business is a relatively straightforward process.

The Nicaraguan Government operates a One-Stop Shop for Investment (Ventanilla Unica de Inversiones, or VUI) within the Ministry of Trade, Industry, and Development (MIFIC) to streamline investment and business licensing (see www.mific.gob.ni). The VUI claims that the average time for registering a business is fifteen days.

However, investors report considerably longer times, and a 2006 World Bank study estimated that the process takes 39 days (see <http://info.worldbank.org/governance/>). The services of the VUI are equally available to domestic and foreign-owned businesses. The Embassy strongly recommends the retention of an experienced attorney for any investor interested in establishing a presence in Nicaragua.

See nicaragua.investway.info for additional information on registering a business.

¶140. The Competition Promotion Law (2006/601) creates a Superintendency for Competition to investigate and discipline businesses engaged in anticompetitive business practices, including price fixing, dividing territories, exclusive dealing, and product tying. To date, the National Assembly has not funded the superintendency and the competition law remains unenforced.

¶141. The Consumer Defense Law (1994/182) includes a consumer bill of rights that establishes minimum standards for product safety and quality as well as for truth in marketing. Under this law, MIFIC's Consumer Defense Directorate may investigate business and levy fines. The Ministry of Public Health, Directorate General of Sanitary Regulation, regulates the sale of food and drugs (including cosmetics), while the Ministry of Agriculture and Forestry is responsible for plant and animal health issues (see Chapter 5: Trade Regulations, Customs, and Standards of the Country Commercial Guide for further information on food, drug, and consumer product regulation). Government resources to enforce these public health and safety regulations are limited, especially in informal markets.

¶142. The Directorate General of Taxation in the Ministry of Finance and Public Credit collects income and value-added taxes, as set forth in the most recent version of the Tax Code (2006/598). The Directorate General of Customs in the Ministry of Finance and Public Credit collects customs duties (see Chapter 5: Trade Regulations, Customs, and Standards of the Country Commercial Guide for further information on customs procedures). Investors cite arbitrariness in taxation and customs procedures, as well as a lack of delegation of decision-making authority. Tax audits of foreign investors have increased in frequency and duration, to the point where they may hinder normal business operations. Investors also complain that customs authorities wrongly classify goods to boost tariff revenue.

¶143. The Environment and Natural Resources Law (1996/217) authorizes the Directorate General for Environmental Compliance, Ministry of Natural Resources and the Environment (MARENA), to evaluate investment plans and monitor ongoing operations to verify compliance with environmental standards (see www.marena.gob.ni). The Law on Crimes against the Environment and Natural Resources (2005/559) includes additional environmental standards. Some investors complain that MARENA takes political considerations into account in determining whether to issue an environmental permit. Budgetary constraints limit MARENA's ability to enforce environmental standards.

¶144. In addition to environmental regulation, mining investments are regulated under the Special Law on Mining Prospecting and Exploitation (2001/387), which is now administered by the newly created Ministry of Energy and Mining. The Ministry of Energy and Mining also retains the authority to grant oil and gas exploration concessions. In 2007, the Supreme Court ruled that several oil exploration concessions had been granted without proper consultation with the governments of the autonomous regions on the Atlantic coast, though the concessions were situated outside recognized

regional waters. The central government used the ruling as leverage to re-negotiate more favorable terms.

¶45. The telecommunications sector is fully privatized and open to competition. Under CAFTA-DR, Nicaragua opened its telecommunications sector to U.S. investors, service providers, and suppliers. U.S. exports of telecommunications equipment receive duty-free treatment. CAFTA-DR establishes rules promoting competition in telecommunications services and addresses key regulatory concerns that may create barriers to trade and investment in telecommunications services. Enitel, the former state telephone company, is now 99% owned by a Mexican company. The mobile telephone industry in Nicaragua is served by two nationwide operators. Enitel controls switching for all cellular service. The Nicaraguan Institute for Telecommunications and Postal Service (TELCOR) regulates the sector and has generally encouraged competition (see www.telcor.gob.ni). CAFTA-DR requires the establishment of a fair and transparent pricing regime.

¶46. The Electricity Sector Law (amended 2004/465) and the Energy Stability Law (amended 2007/627) establish the legal framework for the electric power sector. The Ministry of Energy and Mines Law sets policy for the sector and grants licenses and concessions to investors, while the Nicaraguan Energy Institute sets prices and regulates the industry (see www.ine.gob.ni). Investment in transmission and distribution is limited by law (see Right to Private Ownership and Establishment). Investment in this sector has been constrained by regulatory and political uncertainty and by a complex tariff system that does not provide clear incentives to generators. Growing demand and the lack of maintenance has resulted in extensive, rolling blackouts throughout the country during much of 2007